

# Global Outlook

October 2025

## Structural challenges increasingly exposed

Fiscal sustainability increasingly in focus,  
market discipline in action

Developed market monetary policy setting  
becoming more challenging

New Zealand's green shoots

BEVAN GRAHAM

## Implications For Investors

Global equity markets rallied on solid earnings and a "blind  
date" with A.I. profitability.

Rising costs raise risks to corporate margins and could imply a  
cold shower ahead in the US.

NZ equities move onto a stronger footing, and Reserve Bank's  
OCR cuts can underpin gains.

GREG FLEMING

# Structural challenges increasingly exposed

Being in government in a developed economy is becoming increasingly challenging. In many countries growth is low, yet high inflation is limiting the scope for central banks to lower interest rate much further. At the same time, years of fiscal stimulus, pandemic support, and populist spending have left sovereign debt burdens historically high and on a sharp trajectory higher, requiring increasingly urgent action.

With interest rates no longer anchored near zero, debt servicing costs are climbing sharply, narrowing fiscal space to fund all the things the voting public expects, nay demands. Governments can no longer rely on deficit-financed demand management without undermining investor confidence or risking bond market discipline, as seen in recent episodes of bond market volatility around the developed world.

At the same time, housing, long a reliable engine of consumption through wealth effects and construction, has stalled. Flat or declining house prices mean households no longer feel richer, and mortgage refinancing no longer delivers spending power. With real estate unable to carry growth, and fiscal policy constrained, the demand-side levers of the past look exhausted.

Supply-side growth as the only sustainable path forward. Raising productivity through investment in innovation, digital adoption, infrastructure, and human capital is essential to lift potential output. Regulatory and planning reforms are needed to ease bottlenecks in housing supply, energy transition, and labour markets. Immigration policy must target skills that complement domestic workers, while tax systems should be re-oriented toward incentivising investment rather than consumption.

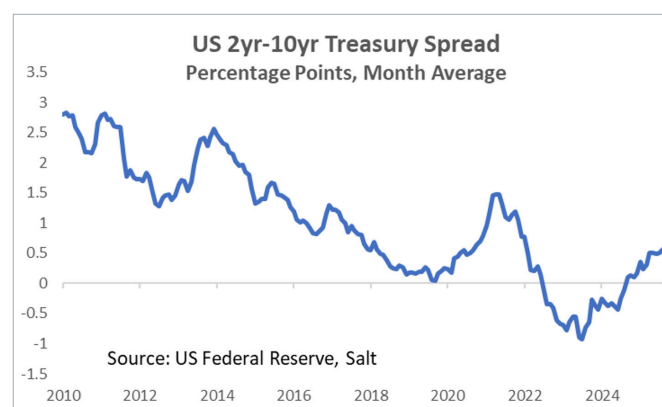
In short, the growth model built on cheap credit, rising house prices, and debt-funded fiscal expansion has run its course. For high-debt, low-housing-tailwind economies, the only route to sustained prosperity is to expand productive capacity. Without a credible shift to supply-side reform, stagnation and fiscal stress will become the default and an increasing source of angst for bond markets.

So, if you're considering politics today, don't chase votes

with promises you can't fund—be the one who levels with people about hard choices, focuses on structural reforms that lift long-term growth, and has the courage to stay the course. In an era of slow growth and tight fiscal space, credibility, vision and, above all, being able to articulate a plan will matter more than ever.

## Fiscal sustainability in focus, market discipline in action

Yield curves across the developed world have steepened sharply since our last report, with long-term rates rising relative to the front end. This is not merely cyclical noise: it reflects a structural re-pricing of risk in global capital markets.



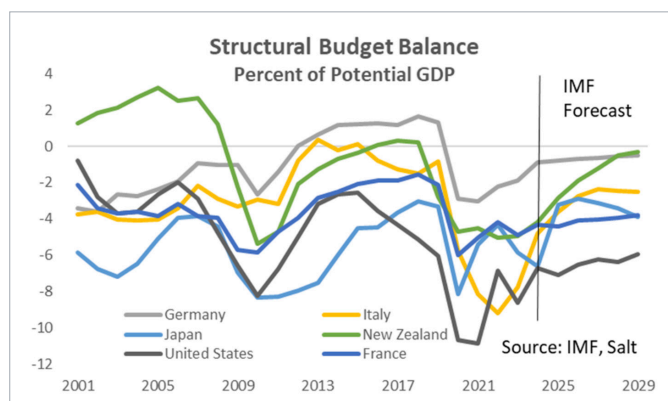
Several forces are at play. As we have argued previously, neutral policy rates have shifted higher. Fiscal deficits in key advanced economies are proving both large and persistent, leading to heavy sovereign issuance at a time when central banks are scaling back their purchases. Investors must absorb the marginal supply and are demanding greater compensation for doing so. At the same time, inflation risk premia remain elevated, and the structural backdrop of ageing populations and shifting global savings patterns is eroding the conditions that once kept long-term yields suppressed.

The drivers are clear. The U.S. is running structural deficits of around 6–7% of GDP, with debt on track to exceed 120% of GDP and interest costs rivalling defence spending. The U.K. faces debt near 100% of GDP, compounded by high inflation-linked issuance that makes servicing costs highly sensitive to price shocks. France and Italy wrestle with debt ratios of

114% and 137% respectively, amid weak growth and fragile coalitions. Japan remains the outlier, with debt above 250% of GDP, though curve steepening here is partly due to the long-delayed normalisation of inflation expectations, as core inflation stabilises over 2%.

### The politics of fiscal consolidation are challenging

There are no easy options in reducing structural deficits. Governments can impose expenditure restraint, look for new revenue by either broadening the tax base or adjusting the rates of existing taxes. The most politically palatable but hardest to achieve option is to institute growth-oriented reforms that improve productivity. Cutting spending or raising revenue are politically difficult, but without them, markets will continue to impose discipline through higher long-term rates.



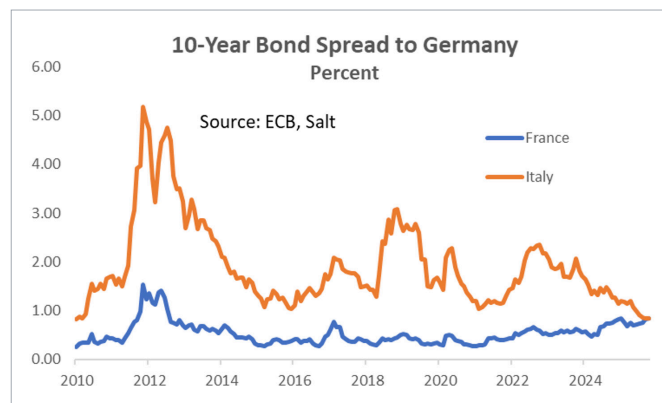
Inflating the debt away is not an option. History shows that deliberately tolerating higher inflation to erode the real value of liabilities only undermines fiscal credibility, drives up borrowing costs, and shifts the burden onto households through higher living costs. Markets quickly price in the strategy by demanding higher long-term yields, offsetting any short-term erosion of debt ratios. Instead of easing the problem, it compounds it, turning inflation into a fiscal as well as a monetary failure.

For policymakers, the lesson is simple: credibility is everything. Markets will not tolerate attempts to inflate debt problems away. The only sustainable path is through credible fiscal consolidation and growth-oriented reform. For investors, the message is equally clear: steepening yield curves are not just a market signal, but a warning of the price of fiscal drift.

### France as the new Italy?

Remember when we used to talk about the Eurozone's debt problems being in the periphery and the biggest problem facing the Euro was Grexit? Then for a while there was chatter about a North/South divide when Italy's problems intensified. With France the most recent source of fiscal duress in Europe, the problem is now at the core.

France's debt to GDP ratio, at 114% (and rising), is the third highest in the Euro area, behind only Greece and Italy. French bond yields are now higher than those of Italy, driven by recent political instability in France as various Prime Ministers have tried to steer an austerity Budget through the National Assembly.



The latest to try and fail was Francois Bayrou who lost a confidence vote in early September as he tried to push through his proposed austerity package "Le Moment" which aimed to cut the deficit by €44b. His successor, Sebastien Lecornu, lasted less than a month, failing to even put a government together. This is a continuation of the political instability that has dogged President Macron since his ill-fated decision to hold legislative elections last year that were intended to shore up his centrist mandate but did the complete opposite, delivering a fractured and fractious legislature.

The good news is that following the Eurozone debt crisis the Stability and Growth Pact, the central fiscal framework of the common currency, was strengthened as backstops such as the European Stability Mechanism were developed. However, the credibility of the SGP has always been tested by the tension between rigid rules and political realities.

In that environment, France's fiscal slippage is a major credibility risk. If the second-largest economy in the common currency is allowed to become fiscally unreliable, the euro loses part of its political and financial anchor, complicating policy making for the ECB. But above all, it should serve as a warning to other countries struggling to navigate a path to fiscal sustainability.

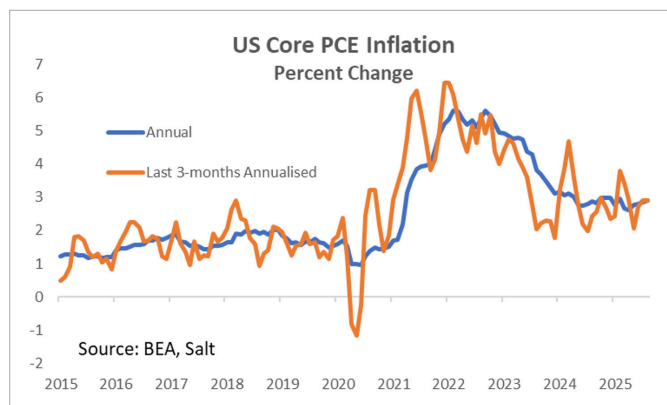
### Setting monetary policy becoming more challenging

In the United States, the Federal Reserve has been navigating two clear and present dangers – upside risks to inflation as higher tariffs are passed onto consumers, and weakness in the labour market.

For most of this year the Federal Open Market Committee (FOMC), the rate setting Committee at the Fed, has deemed the upside risk to inflation to be the bigger risk of the two. That changed, however, with the

release of the July labour market report in early August which saw employment growth surprise to the downside and saw sharp downward revision to prior months. That saw various members of the FOMC pivot to the labour market being the bigger risk, markets price in more monetary easing and eventually saw the FOMC deliver a cautious 25bp cut at the September meeting.

As has been widely expected, and forecast by the FOMC's Summary of Economic Projections, core PCE inflation has been rising and currently stands at 2.9% in the year to August. It appears likely to head higher. Tariff-pass through has been less than feared, however with most of the impost being worn by US importer margins, it seems only a matter of time before businesses seek to restore margins and pass the higher cost onto consumers.

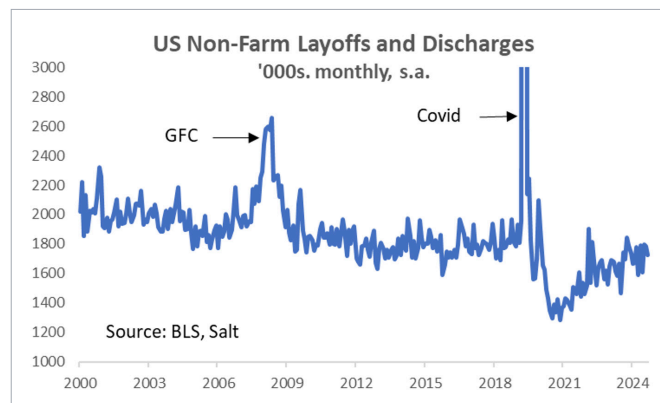


We think the real inflation risks lies in the price of services. The reality is the US economy is still growing at a solid clip – June quarter growth was revised up to a seasonally adjusted annual rate of 3.8% and the current quarter looks likely to come in at around 3.0% also – and despite the recent weakness in employment growth, the unemployment rate is still low indicating a labour market that is still tight. Indeed, the annual rate of increase in core services (ex-housing) inflation has accelerated over the past two months. Easing further now means the FOMC believes the weakness in the labour market will ultimately serve to bring inflation sustainably back to target.

But that poses the question: just how weak is the labour market? Recent data tells us that labour market demand has fallen sharply. But what if that's a function of lower supply, driven by changes in immigration policies, rather than due to weakness in the economy? We've long argued Trump's immigration policies are the part of his agenda that are least understood and appreciated by markets. Indeed, while the monthly growth in payrolls has slowed sharply, the unemployment rate is still only at 4.3%, still below its long-term trend level.

For the labour market to be called genuinely weak, we'd expect to see an increasing number of layoffs starting to come through the data. But while layoffs have trended

higher since their post-GFC low, they appear to be stabilising at a lower level than that which prevailed prior to the GFC, and in the period between the GFC and the pandemic.

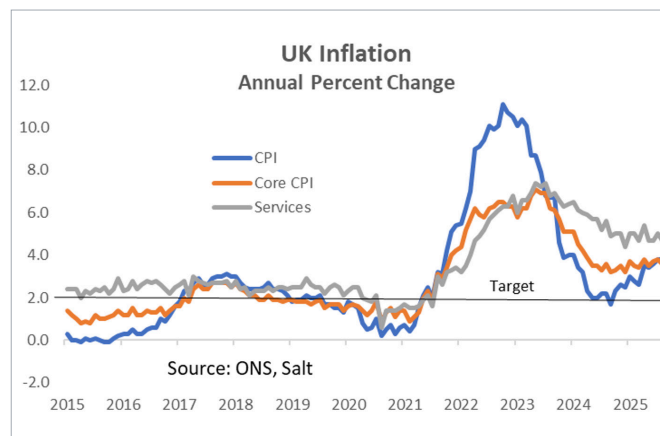


We think there is good reason for the FOMC to be very cautious about any further easing. Most recent Fed-speak has turned more cautious about the monetary policy outlook with many comments citing elevated inflation and labour market tightness. Only Stephen Miran, President Trump's recent appointment to the Fed, is arguing for faster and deeper interest rate cuts.

### Caution in Europe

While Eurozone growth is proving more resilient than expected to ructions in the global trading environment, the pace of growth remains only modest. Further disinflation is possible, but the recently more balanced tone from the European Central Bank suggests to us that while further easing in monetary policy is possible, the ECB is more than likely done. Another cut from the current deposit rate level of 2% would require a downside surprise to growth or inflation.

The Bank of England has reduced interest rates cautiously, moving only once a quarter as the Monetary Policy Committee navigates sluggish growth but also wage growth and inflation that are still too high for comfort. The bank rate currently stands at a still restrictive 4.0%, justified by core inflation which came in at 3.6% in the year to August.



BoE communications stress that future easing will require clear evidence that inflation is firmly on a downward trajectory while Governor Bailey has recently stated in public comments that “we’re not out of the woods yet regarding inflation”. We agree with his assessment.

Scope for further easing may be allowed following the release of the UK Budget at the end of November. Should measures included in that prove more restrictive than currently anticipated, that could open-up room for further monetary policy support.

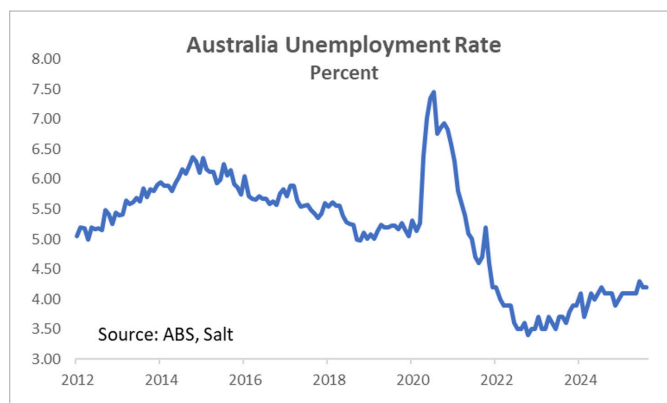
### Japan on a different trajectory

The Bank of Japan held interest rates unchanged at 0.5% at its September meeting, though in a hawkish twist, it was not a unanimous decision. The vote was 7:2 in favour of no change with the 2 preferring to hike rates 25bp to 0.75%. This is a clear sign of a divide at the BoJ about when to raise rates. In another hawkish surprise the BoJ also announced its decision to start to sell its holdings of equity ETFs and J-REITs into the market at an annual pace of ¥330bn (US\$2b) per annum.

It is clearly the lingering downside risks to the economy from export demand, global tariffs, and domestic weakness, along with Japan’s own recent political instability, that is tempering the enthusiasm for further rate hikes. Nonetheless, strong business sentiment, strong wage growth and upward inflation surprises lead us to believe the next rate hike could come before the end of the year.

### Hawkish RBA

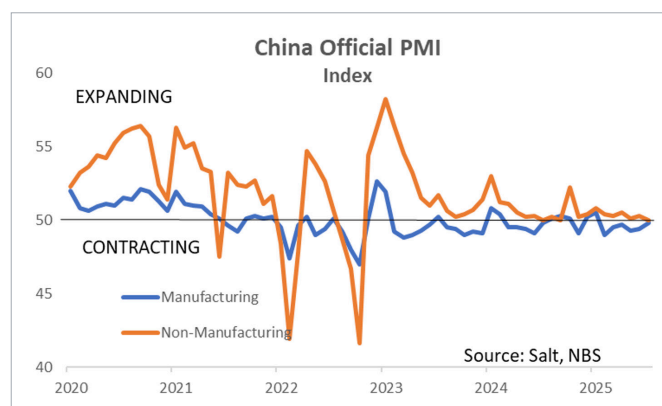
The Reserve Bank of Australia left interest rates unchanged in September as was widely expected. The Statement and post meeting comments were justifiably hawkish (in our view) and probably more hawkish than the market was expecting on average.



Markets have now lowered the probability of a rate cut in November to around 40%. We think there’s a high hurdle for further cuts anytime soon. The reality is that growth is improving, the labour market is tight, and inflation is surprising to the upside.

### Uneven momentum in China

The near-term outlook for China is one of uneven momentum with overall growth likely to continue to moderate. Real GDP growth of around 4.5%-5.0% appears likely in 2025, easing further in 2026. While headline numbers remain respectable, a look under the hood tells us the underlying composition is of that growth is soft as consumer demand remains hesitant, the property sector continues to weigh heavily, and external headwinds (notably higher U.S. tariffs) are increasingly biting. Factory orders have been contracting, and business investment sentiment is fragile in many regions.



Given these conditions, the scope for additional policy support is likely though constrained by structural limits and evolving political priorities. On the monetary side, the People’s Bank of China has already signalled a more proactive stance, pledging to “step up monetary policy adjustments,” maintain ample liquidity, and guide credit growth, especially to private firms and smaller enterprises. In the first half of 2025, moves such as cuts in the reserve requirement ratio (RRR) and modest adjustments to short-term rates were deployed. Additional leeway exists for further interest cuts or targeted reductions in funding costs, so long as financial stability risks around local government debt and nonperforming loans are managed.

Fiscal stimulus is more straightforward but must be used judiciously. The authorities have already announced a reasonably ambitious fiscal impulse of around 1.5% of GDP in 2025 via infrastructure, subsidies, social protection, and trade-in programmes. More could follow in the form of infrastructure projects, selective local government investment, direct consumer subsidies (such as interest subsidies for consumer loans) and expansion of social safety nets to support consumption. However, there is a delicate balancing act. Over-reliance on investment stimulus risks exacerbating debt imbalances or misallocating capital into low-productivity projects.

In the short run, policymakers have room to lean in with additional monetary tweaks and targeted fiscal support. But beyond that, sustaining growth will increasingly depend on structural reform, especially efforts to

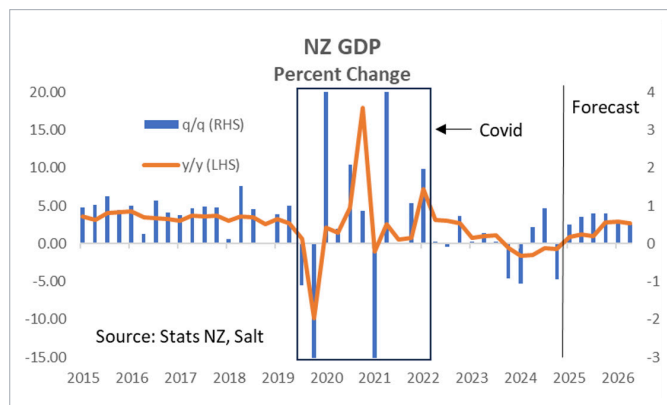
rebalance toward consumption, boost productivity, and alleviate demographic and debt constraints. And as we have long said about China, avoiding policy mistakes is key.

### New Zealand's green shoots

We weren't overly surprised the New Zealand economy didn't grow in the first half of 2025. We've always thought the emergence of a sustained pick-up in activity would have to wait until the second half of the year. What did surprise us was the no-growth was the sum of +0.9% expansion in the March quarter, followed by an equal-sized contraction in the June quarter.

As the first half of 2025 evolved, it became quite clear that the NZ economy was weaker in the second quarter than it was in the first. GDP growth surprised to the upside in the three months to March, but it was very narrowly focussed. The news flow then deteriorated in the three months to June. The reasons are debatable but certainly the unfolding trade war between the US and everybody else could have been a contributing factor.

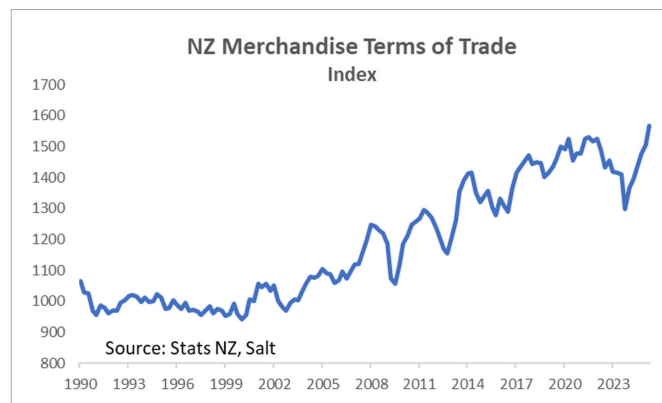
So, the pattern of reported GDP growth over the first half of the year does make sense. But we think the upwardly revised +0.9% growth recorded in the 3-months to March probably overstated that quarter, while the -0.9% for June probably overstates the weakness now. For the record, we thought we'd see -0.4% in the June quarter with a high probability that the March quarter would be revised down. Instead, it was revised up from the initially reported +0.8%.



The good news is green shoots are emerging, and the data is improving, though this appears likely to remain constrained by the absence of two traditional tailwinds of New Zealand growth, migration-led population growth and house price inflation.

On the positive side the Terms of Trade is on a tear, rising 20% since its most recent low at the end of 2023. That's the combined impact of a 17% rise in exports prices and a 3% fall in import prices. The stronger export prices are a boon for provincial New Zealand, which is why when

you look at any regional activity data, the provinces are doing better than the cities, particularly Auckland and Wellington.



Such has been the improvement in the data that it looks like September quarter GDP will come in stronger than the RBNZ's current forecast and may make up for most, if not all, of the undershoot in the June quarter.

The RBNZ responded to the emerging weakness in the June quarter by reducing the Official Cash Rate by 25bp to 3.0% and adding an extra 25bp cut into their interest rate projections at the time of the August Monetary Policy Statement (MPS). But given the size of the GDP miss, the RBNZ responded by delivering the full 50bp of projected cuts at their October meeting and signalled a willingness to ease further.

The key monetary policy risk now is the RBNZ overdoes it. The whole point of inflation targeting is to smooth the economic cycle. A question worth thinking about is whether the RBNZ is creating the cycle to smooth inflation.

NZ's potential growth rate, the rate of growth that is consistent with target inflation, remains low. That means that once the spare capacity is used up, we hit growing pains early, and the RBNZ need to hit the brakes again.

That's why the Government needs to become far more focused on improving our perennially moribund productivity performance. That means focussing on things like expenditure efficiency, education, skills, the regulatory environment, infrastructure and digital transformation, to name a few. Until we get these things right, low interest rates will only ever provide a temporary sugar-hit before the lid goes back on the cookie jar.

Gathering the fortitude to make potentially courageous changes to lift productivity is how the Government should be measured rather than panicking in response to a blame-game over a GDP number that will soon become ancient history.

## **Focussing on the positives**

While the global macro environment seems awash with challenges, there are positives out there as well. First, corporate balance sheets in many advanced economies remain resilient, with firms continuing to adapt to higher input costs through efficiency gains and technological adoption.

Second, labour markets, while cooling, remain relatively tight (New Zealand is an exception), supporting household incomes and consumption, which reduces the risk of a deep downturn.

Third, for long-term investors, higher interest rates themselves create opportunities. Fixed-income markets now offer more compelling yields than at any point in the past decade, and equity valuations in some regions are beginning to reflect a more realistic pricing of risk. In this regard, European and Japanese equities have begun just recently to resolve their multi-year lag of the all-conquering US share market and its mega-cap technology titans.

In other words, while the macro narrative feels dominated by risk, the investment landscape is offering new entry points and opportunities.

*Bevan Graham*



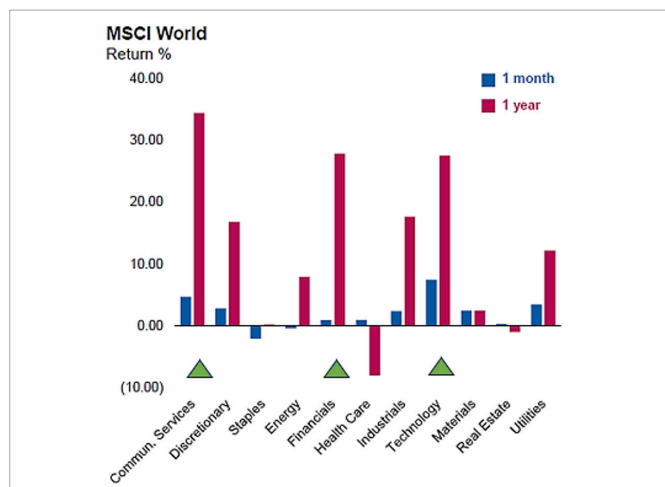
# Implications for Investors

The chief dilemma for investors as 2025 moves into its final phase is the degree to which equity markets are accurately – or over-optimistically – reading the forces at play in the policy-afflicted US economy, and their ramifications for assets in the rest of the world. The period since May 2025 has seen an extraordinary degree of market indifference to a widening array of threats to the US domestic economy. Investors focussed instead on the future productivity-enhancing scope of artificial intelligence (A.I.) and on the scope for US corporate and personal tax reductions and deductions scheduled to take effect into 2026 and subsequently. Global bonds therefore lagged equities and infrastructure for the third quarter of 2025.

The sheer force of the US equity rebound in the last five months has left other asset types struggling to keep pace. Bonds, in particular, have managed a 4%-6% 2025 YTD return, which would be well-regarded given still-persistent inflation levels, but for the scale of the contrast with supercharged equities' returns.

Longer-duration Treasury bonds have been weakest, with US 10 and 30-year securities' returns failing to keep pace with inflation over the last year, thereby delivering a negative real return despite Fed. easing.

## Sectoral dispersal of returns remained Tech-heavy in September



Source: Morningstar, 30 September 2025

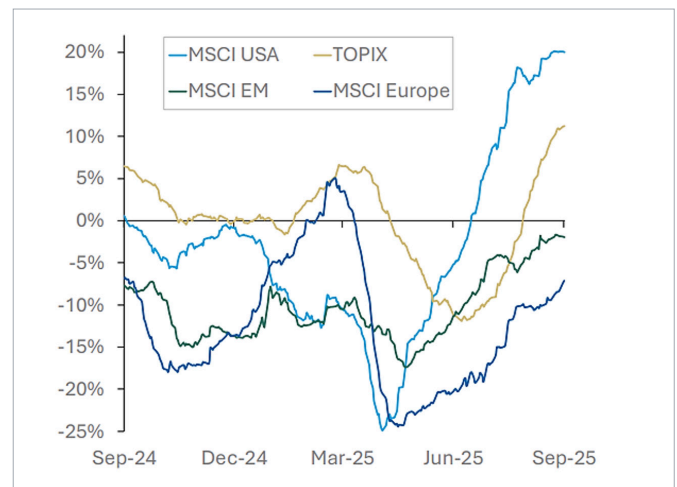
Unusually, the 2025 strength in international equities has not only been a US story. European share markets have performed even more strongly, with Spanish and Italian

shares up by over 25% and the German DAX index gaining 22% - ahead of even the US NASDAQ 100's 18% year-to-date gain and the 12% rally in the S&P 500. European shares started from a more valuation-friendly position, and still trade at a considerable price-earnings ratio discount compared to US equities, with a current P/E of 14.6x for the MSCI Europe Index, compared to 22.9x for the S&P 500.

A rare feature of markets also asserted itself, with gold prices moving ahead of equities and logging a 50% year-to-date gain, as disquiet mounts about what counts as a safe haven asset nowadays. Government bonds and the US dollar have faced rising scepticism, given the unconventionality of US policies at present.

These strong market returns are aligned with the rebound in the corporate earnings picture that has unfolded this year, although arguably the degree of relief from April's tariff-shocked pessimism may have now run its course pending new, positive information. This may be in short supply, as the forward-looking indicators do suggest a slowdown is underway in the US real economy, as elevated uncertainty locks up investment and employment plans on behalf of both businesses and (especially) government agencies.

## Corporate earnings forecast breadth soared after tariff-shock trough



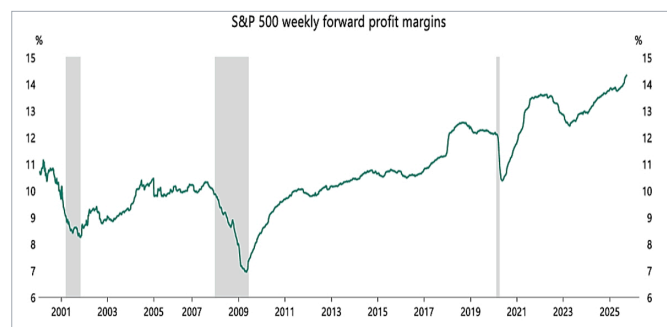
Source: FactSet, IBES, MSCI, Morgan Stanley Research

As the chart above shows, the balance of companies for which analysts expect profit upgrades has swung wildly this year, from a net -25% in April to a +20%

reading for US companies last month. Japan has also experienced a recent upswing in its companies' earnings revisions breadth, while for Europe and Emerging Markets (EM) the upturn has been less pronounced. However, it is important to note that these forecasts are an upward correction from a near-disaster scenario, which was the consensus view in April when President Trump's so-called "Liberation Day" tariff regime was first revealed. Countries and regions that are more notably in Trump's "bad books" are seeing commensurately less analyst enthusiasm for their earnings paths, as would be expected, given that the America First agenda is expressed via many tools. The novelty of using US trade tariffs as a weapon of geopolitical influence has taken some larger emerging markets like Brazil and India by surprise, to say nothing of the impact of countries in China's sphere of influence.

Six months on from the April tariff blitzkrieg, there has been some scope to gather evidence on the preliminary effect of the tariffs the US has chosen to impose on the profitability of US companies and the health of the corporate sector. So far, the negative impact on profits has been quite limited, as companies adopted a range of mitigating strategies such as pre-ordering and stockpile building, supplier substitution, and seeking price discounts from suppliers shipping from targeted exporter countries. However, there are early signs that despite top-line earnings resilience, profit margins are likely to be eroded somewhat from their record levels above 14% on average for S&P 500 companies.

### US S&P 500 profit margins have been very high



Source: Bloomberg, Macrobond, Apollo. Recessions are shaded.

The chart above smooths US profit margins by means of a weighted average of current year estimated margins and next year's consensus estimates. On a simpler, quarterly basis, FactSet data indicates a likely softening in profit margins in Q3 2025 to 12.7%, which remains above the five-year average of 12.1%.

On the balance of incoming evidence like rising costs to producers moving along the pipeline, discounting to consumers to keep sales from flagging in a period of diminishing confidence, and cost sensitivity throughout the economy, it's probable that profit margins will be progressively squeezed. Whether such a squeeze

is sufficient to upset the optimistic current market assumptions on A.I.-transformed profitability prospects is a difficult call, because so much of the cost-reducing claims of A.I. proponents are yet to be realised. Margins may remain high, if product prices do not enter a deflationary trend – historically rare, for Information Technology. Potentially, A.I. can streamline many production costs, but will that automatically translate to net profits? Consumer preferences in these areas can prove unpredictable.

### "Knowledge economy" service sectors experiencing non-tariff cost pressure

Last Quarter, we highlighted the potential pressure on US corporate margins from tariff pass-through, noting that our global equity investment partner, Morgan Stanley, estimates that if non-financial corporations had to pay June-level tariffs and absorbed them entirely in profit margins, quarterly profit margins would have fallen to 11.7% from the 13.8% actually recorded. High margins attract investors, as IT has shown. Even US tariff-light sectors, which sell services or "intangibles" are indicating that cost pressures are increasing. Cost increases are not as easily passed on to customers in the services sector.

There is a marked differentiation between "goods-producing" companies that sell physical output which may require overseas manufacture / componentry, and "services-producing" firms such as software and communications services, where the customer end-product is digital and thereby largely untouched by tariff impositions. No surprise that the Information Technology (I.T.) and Communications Services sectors of the US equity market have been the strongest performing in 2025-to-date, with returns of +22% and +24.5% to end-September, respectively. Most investors assume these sectors are Trade War-proof.

Artificial Intelligence companies are more ambiguously-placed as we look forward into 2026. While their product is quintessentially non-physical at present (though in time, many manufacturing processes will be transformed,) the A.I. industry is overwhelmingly reliant on the hard infrastructure of high speed / high-capacity microchips to run the ever-more demanding processing requirements of widening A.I. usage.

Chips are a globally-traded, near-commoditised product (despite shortages in very high-end Graphics Processing Units or GPUs) and while the US is taking rapid steps to on-shore as much chipmaking industrial power as is viable, the dominant suppliers of high-performance chips are not US-domiciled. Taiwan has the lion's share of high-end microchip plants, and Europe has much of the photolithography capacity in the Netherlands, Austria and Germany, with additional Asian capacity in

China, Japan and South Korea.

## Digital infrastructure is transnational, too

Thus, the supply chains supporting Artificial Intelligence cross international borders and are thereby subject to degrees of geopolitical and trade policy risks. To give one example, the US Government has recently announced a strategic stake in Intel in order to ramp up a US-based advanced microchip output drive. Nevertheless, the installation of the Dutch (ASML) High NA machinery at Intel's Oregon chip fabrication facility last year required modules manufactured in Germany and the Netherlands as well as the US components, and for the time being, full assembly and testing of such giant equipment occurs first in the Dutch production plant prior to its disassembly and export.

As ASML is the only manufacturer of Extreme UltraViolet photolithography technology, it has the market cornered and charges US\$400 million per machine. Until such a time as the US and other major industrial economies can reproduce this precision technology at scale, the chipmaking industry will need special carve-outs from tariff and trade-restricting government programmes. A vital technological foundation of much advanced consumer electronics which relies on uninterrupted componentry flows between the US and Europe, Korea and Taiwan will, for some time to come, remain rather vulnerable to cruder political engineering and at times, tensions. Import substitution plans like building a fully-independent US chip-making industry with no reliance on global trade and technology flows is more rhetoric than reality.

## The One-note Narrative

Why would this ASML case study raise some grounds for prudence for equity investors? Our global investment partner for equities, Morgan Stanley's Investment Committee puts the case for caution rather succinctly:

*As the US equity bull market approaches its three-year anniversary, with the S&P 500 having gained nearly 90%, it's hard not to still see it as a boom driven by a one-note narrative—far from current debates about employment, inflation and monetary policy. Since ChatGPT's launch, A.I. data centre-ecosystem stocks have accounted for roughly 75% of S&P 500 returns, 80% of its earnings growth and 90% of its capex growth...., it's difficult to ignore the market's reliance on A.I. capex...and several developments indicate we may be entering the later phases of the boom.*

*First, AI hyperscaler free-cash-flow growth has turned negative. Second, price competition in the "monopoly-feeder businesses" seems to be accelerating. Finally, recent deal-making smacks of speculation and vendor-financing strategies of old.*

*While stimulus may improve prospects, it is hard to anticipate this bull market surviving if the GenAI capex-boom story falters. And we are seeing cracks.*

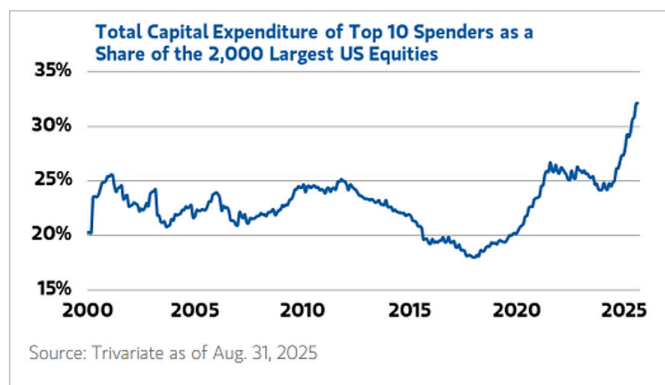
Seen in retrospect from the year 2028 or 2030, it may indeed prove to be the case that Artificial Intelligence emerged mid-decade as the catalyst for embedding the Fourth Industrial Revolution deep into global production and consumption, and those who dominated its "raw materials" – chips and data centres – were visionaries whose enterprises vindicated aggressive market valuations en route to industrial hegemony. This view is associated with the Thiel / Altman / Musk star CEO movement.

However, it is also a risk case worth considering, that in 2028 or 2030, professional investors may look back on the A.I.-themed equity bull market of 2025 as another instance of over-hyping and over-paying for a semi-proven technology, at least in terms of its value-adding potential. To maintain serious valuation premia over the years and decades ahead, major A.I. users and infrastructure investors (the "hyper-scalers") will need not only to demonstrate that there can be a steady and even accelerating monetary return on their massive expenditure in terms of chargeable usage, but also that their proprietary technologies are not easily copied or replicated by lower-cost competitors who can supply a comparable user experience for a fraction of the hard-won user subscription price. Moats are quite slender, when rewards can be so high, and many industrial and post-industrial countries are chasing the vision.

Even cyber-capitalism is still capitalism. Competitors in social media and cloud-based services abound, and it is far from assured that some incumbents operating in chargeable A.I. applications will lock up this application market for long enough to recoup the enormous investments already made – data centre capital expenditure (capex) for instance is running at US\$400 billion per annum. Keeping these server farms up-to-date will require vast maintenance budgets, as nothing goes obsolete as quickly as I.T. hardware.

The potential for A.I. is substantial, but the current degree of "blue-sky" extrapolation from some in the investment community does seem to be well ahead of the evidence in hand on profitability. Time will tell, but there is a small and shrinking margin of error in the US economy and market, where many growth-focussed market participants appear distracted by the technological horizon from mounting tangible problems in the labour, housing, and personal debt arenas. Society does not yet have algorithms which can solve for the status quo negatives like high indebtedness and increasingly prevalent get-rich-quick thinking in the crowded cryptocurrency parallel universe.

## US capex boom in A.I. data centre-linked expenditure added 1% to US GDP



The speed of growth and scale of the data centre investments are skewing the aggregate economic impact, with the top 10 spenders (hyperscalers) now accounting for nearly a third of all spending—well ahead of the 25% share of the biggest telecom-infrastructure builders in the dot-com peak era of 2001.

While this 2020s narrative may have longer to run, analogies to the 2000 “Cisco moment,” when a few companies slowed investment on fears of overheating, are increasing. In the long, but terminal, crescendo of the dot-com period from 1999-2001 many more fundamentals-focussed investors endured a very testing couple of years, as stocks which were well-exposed to the technological narrative continued to march ever upward and investors who were not willing to chase the momentum suffered inferior returns from their global shares holdings. At that time, a good many active investors threw in the towel and capitulated to passive indexation – just as the market values of the listed enterprises peaked and commenced a decade of declines and / or sluggish performance. Thus commenced the “Lost Decade.”

### “No-one rings a bell at the top of the market”

Given the momentum in all things microchip and A.I.-themed now underway, it would be imprudent to predict a negative turning point for ebullient sentiment on these increasingly dominant segments of the US and thereby, Global equity markets. Typically, very-richly priced equity market sectors require a substantial and systemic shock to reverse direction, like the paradigm shift that GFC banking collapses worked for Financials stocks, to definitively melt the overarching narrative and restore a more fundamental-based pricing in the industry. It is impossible to predict such a shock with any precision, whether with regard to type or to timing.

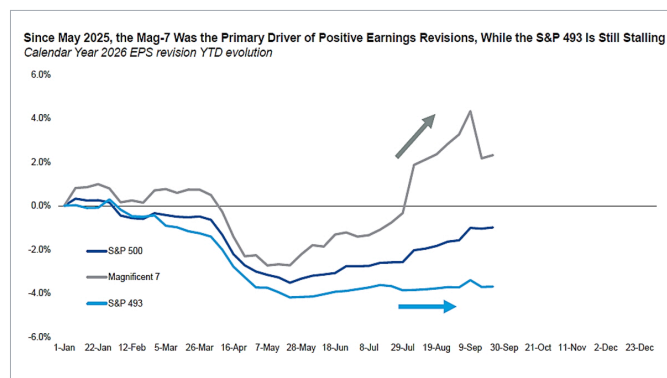
It is prudent to continue investing in high Quality, technology and software enterprises, but to locate the bulk of such investments adjacent to any single technology that is at the centre of the “revolutionary earnings growth” hypothesis. This approach is akin to

investing in companies that supply Emerging Markets, rather than in Emerging Markets themselves, in that it allows participation in the growth potential of a frontier industry / economy, without incurring the worst hazards of over-concentration.

## Scale of Large-Cap. Technology names drags up the Broad Market

Despite expectations for a broadening in US equity market performance, the Mag-7\* remains the primary driver of positive earnings-per-share (EPS) forecast revisions. Meanwhile, profit growth expectations for the S&P “493” (ex. Mag-7) have not yet recovered following April’s Liberation Day-based downgrades. However, the market’s present fixation with the “virtual” or online economy, as opposed to the “real” or Main Street economy in the US, coupled with the sheer size by market capitalisation of the top Technology names, creates a rosier picture for the 2026 US earnings outlook than is perhaps warranted. Watch this space – there is little margin for error, in terms of the growth cases factored into many recent cross-platform Tech. deals and next year is likely to test assumptions.

### US earnings resilience is still very much a Mag-7 story



Source: Bloomberg, Morgan Stanley Investment Management as at 30.9.25

\* The Magnificent 7 (Mag-7) are Amazon, Apple, Google, Microsoft, Meta, Nvidia and Tesla.

## Republican Rodeo: President Trump’s policy path

All the same, on the face of it, markets appear (as at the start of October) to have discounted most of the key risks that were causing significant concern and volatility earlier this year. The apparent flexibility of the Trump Administration when confronted by an adverse investment market reactions (e.g. in April) seems to have re-assured many investors that no substantive threat to corporate profitability or to the broad US and global economy from the President’s platform is imminent.

At the time of writing, the US Government is in shutdown mode with only essential services operating, but such is the market’s indifference to the President’s

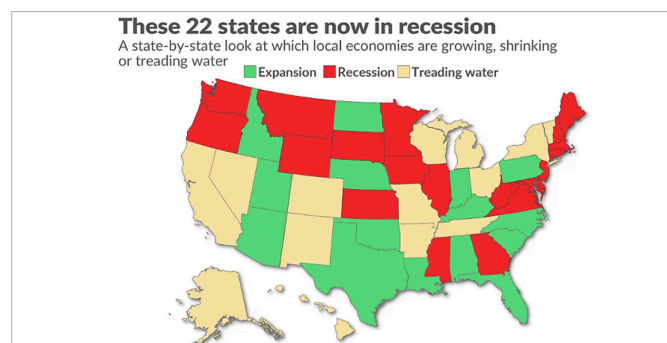
various showdowns with Democrats and others, that record equity market highs have still been daily events. US Treasury markets, though have moved weaker, and alternative safe havens like gold are advancing further, having gained 50% in 2025 year-to-date to all-time highs. Gold even enjoys a positive correlation with the US Equity market now – startling!

However, the prevailing market confidence that “everything will work out fine” does not fully gel with economic data that has built up since the point of maximum pessimism six months ago. The time lags required before sharp behavioural shifts percolate through into economic data are still running, and that there is a degree more optimism particularly in US equity markets than should be warranted on fundamentals. Consequences do take time to show through. Unfortunately for transparency, the government shutdown has delayed the release of key economic readings, and this muddies the waters.

The pass-through effects from tariffs and their impact on corporate margins is elusive, but as tariffs are taxes that impact business margins, a tariff burden can be expected to be evident in corporate financials, given time. Historical data analysis of the last 75 years shows that a decline in corporate profit margins is a reliable leading indicator of zero-growth phases and ultimately of recessionary periods for the US economy.

Interestingly, according to Moody’s Analytics, twenty-two of the fifty US States plus the Washington D.C. area are already in contraction, and that neutral activity in California and New York may be the “swing factor” that could tip overall national activity into a mild contraction some time in 2026. Some “Elderly or Energy States” (e.g., Florida or Texas) are experiencing better growth momentum than the Northeast, the Northwest and much of the Midwest. Recent political affiliation in last year’s election may be playing a confidence role, but the manufacturing industries first impacted by tariffs tend to sit on Republican terrain. This means the 3 November 2026 mid-term Congressional elections will be pivotal for Trumpism.

### US growth dynamism is a patchwork



Source: Bloomberg, Moody’s as at 30 Sep. 2025

A common denominator of those US states estimated by Moody’s to be in recession is that they have weak farm economies and/or faltering light manufacturing. Any part of the country whose economies depend on goods-producing activities, agriculture, mining and light manufacturing is currently weak, due largely to Trump policy impacts but also to demand dynamics, arising from consumers spending more on services than on domestic goods. Additionally, the US housing market remains very subdued, as mortgage rates are still fairly elevated, new home listings are low, whilst the confidence in their work and financial prospects consumers need to make such a major purchase as a home is very challenged.

On the other hand, Trump’s fiscal policies under the One Big Beautiful Bill Act (OBBBA) should see the fading of one overhanging threat to corporate profitability, with key 2017 tax reductions being extended (and new tax deductions being added.) The initial impact should be stimulatory on balance. After the passage of the OBBBA, taxes paid by corporations on the September 15th tax date fell by US\$104 billion, compared to tariff expenses rising US\$94 Bn, a slight net positive for issuers that’s feeding into earnings.

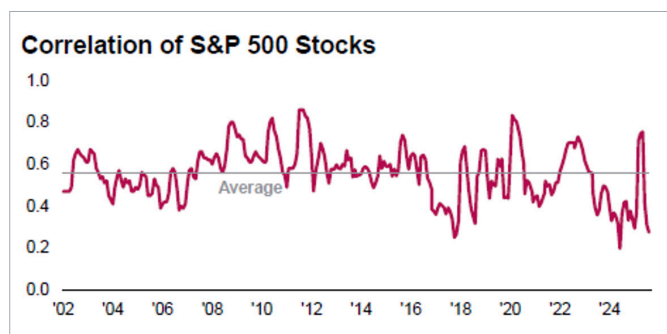
### Inflation debate is still stalking the asset outlook

The most important question for financial markets globally remains, what do all of these novel factors and forces mean for US inflation? On the dovish side of the coin, global inflationary pressures are nothing like what they were after Covid, thanks to tepid overall growth and continuing Chinese excess capacity and deflation. The other ameliorant is that the US unemployment rate has risen from the 3.5% region to 4.3% - potentially diluting the wage pressure on prices that was present 12-18 months ago. However, labour supply in the US is affected by the deportation / restricted entry reforms, as investigated earlier in this Report. That means, a soft labour market’s typical downward inflationary impetus may be now lacking.

Labour market downside risks are rising, lifting market hopes of more aggressive monetary support from the Federal Reserve. Given that, any diminishing of the drivers of recent years’ strong profitability in US enterprises should be born in mind when assessing equity risk tolerance going into 2026. Lower interest rates, if rates are cut fast due to consumer sector weakness, are rarely good for stocks’ near-term returns.

One final note of caution comes from the low present correlation of stocks trading within the S&P 500 Index. After spiking in early April (when most stocks dropped together) the median three-month rolling correlation of daily returns data below shows that on a short-term basis, many S&P stocks are not tracking the large and

sharp rallies being recorded in the well-known Mega Caps with strong A.I. narratives in play.



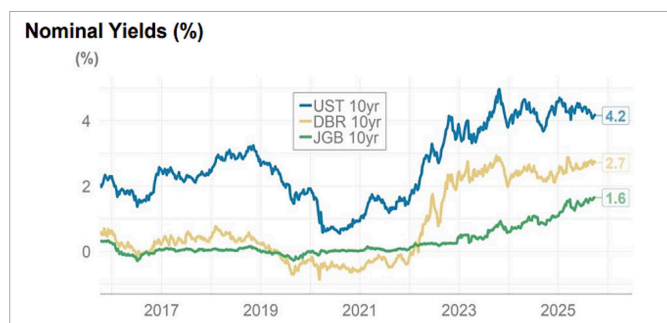
Source: FactSet Research, to 30 September 2025

### The bond diversification argument remains complex

US fiscal adventurism and the accompanying debt-pricing dynamics are another problem zone for investors aiming at achieving a reasonable degree of understanding of their asset choices. While typically, a clearly-slumping global economy would argue strongly for raising Fixed Income securities weightings within multi-asset funds and portfolios, the present situation and outlook makes us rather cautious.

A tension has developed between credit quality and bond issuer scale (in terms of the high Sovereign weightings in many bond benchmarks) that we have largely been able to outmanoeuvre, because we actively invest in global fixed income securities according to the individual bond issuers' opportunity metrics. Our approach stands in sharp contrast to benchmark-constrained bond funds, which are very often automatically heavily-exposed to the most indebted issuers (very often, Sovereign governments.)

### Bond markets are still range-trading at higher yield levels



Source: Bloomberg, Morgan Stanley. Data as at 30 Sep. 2025

The enormity of the global demographic and economic challenges described earlier is reflected in the fiscal furores that have recently been topical in the US, the UK and France, and look ever-more intractable given limited political willpower to adopt fiscal discipline. Other things being equal, that keeps Sovereign yields higher and thereby, elevates the yields on other securities that

derive a spread over a putatively "risk-free" Sovereign interest rate of a comparable tenor. Range-trading US Treasuries mean total returns have remained below average at the 10-30 Year durations, over the last 12 months to 30 September 2025.

Yields & Performance					
Security tenor	Yield %			Total Return (%)	
	Current	1-Mo. ago	12-Mo. ago	1-Mo.	12-Mo.
3-mo. Treasury	3.94	4.14	4.61	0.33	4.38
6-mo. Treasury	3.84	3.97	4.4	0.36	4.37
2-yr. Treasury	3.61	3.61	3.64	0.27	3.52
3-yr. Treasury	3.62	3.58	3.56	0.15	3.56
5-yr. Treasury	3.74	3.69	3.56	0.11	2.99
10-yr. Treasury	4.15	4.22	3.79	0.94	1.35
30-yr. Treasury	4.73	4.92	4.13	3.34	-5.67

Source: Eaton Vance, MSIM, Morningstar to 30.9.2025

In the last few years, that dynamic has come under threat. Cash yields are closely linked to Central Bank monetary policy target interest rates. If those nominal rates (such as the Fed Funds Rate of the NZ Official Cash Rate) are held somewhat higher than they have been over past cycles, due mainly to persistent inflation dangers, the argument for seeking a risk premium by placing funds in longer term debt securities "further out along the yield curve" and taking on duration and/or credit risk becomes more finely balanced. The table above shows that superior Total returns can be achieved by re-investing short-term, which partly explains the very high current balances in US money market funds and commercial paper.

### Our mid-year "upgrade" of NZ equities proved timely

Whilst the New Zealand economy is still in the throes of the very difficult domestic trading environment, we believe that the easing path now well-advanced by the Reserve Bank of New Zealand and the defensive nature of the industries that are heavily represented on the NZ exchange meant that we could anticipate our NZ equity holdings contributing improving returns to the total returns of both the Salt Capital Growth and Salt Income Funds. This paid off in the Third Quarter, with our domestic core equity fund recording a gross return of 6.2% for the quarter, and of 10.5% for the six-months period ending 30 September.

The NZ gains aided our Capital Growth Fund to achieve a 1-year gross return of 8.2% up to 30 September, close to our annual average target return of 8.3% p.a. despite stock selection challenges in Global Equities.

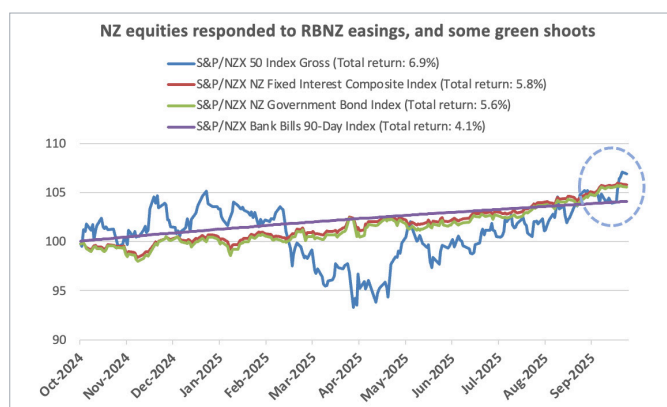
In our Income Fund, the positive impact of the rally in NZ Dividend-focused and Australasian Property Funds in the Third Quarter was even more marked, with

gross returns of 6.4% and 14.7%, respectively. This Salt Income Fund attained a gross quarterly return of 5.9% and a 1-year gross return of 9.9%, ahead of its long-run average target. This is particularly satisfying, set against ever-declining term deposit rates.

However, as the influence of US markets never leaves New Zealand unaffected, equity exposures should be carefully managed, and we are only cautiously and incrementally adding to the NZ equity positioning in our diversified funds. In the Capital Growth Fund, we kept our NZ Equities position Neutral, from a prior -2% underweighting. NZ equity valuation multiples are rather more palatable than either Australian or US shares' - especially if one looks at the NZ market on a median stock basis. The P/E is in-line with its long-term historical norm, and not much higher than the US Small- and Mid-Cap forward Price/Earnings ratios. Whilst not obviously cheap, the NZ market is therefore at acceptable valuation levels and has scope to rise further in early 2026, assuming no major offshore negative turn in risk appetite.

Domestic headline risks remain, as NZ commercial enterprises are still being liquidated, and the Government has not yet identified a "circuit breaker" for the rather downbeat domestic economic narrative, leading to substantial emigration flows across the Tasman, which weighs on private demand. Nevertheless, it seems that there is still a preponderance of pessimism implied in many domestic equity prices, and longer-term NZ investors or international acquirers (after rigorous due diligence and comparative value analysis) will likely begin to accumulate stock in our home Equity market.

**NZ equities' return was interrupted by US April correction, but has resumed**



Source: S&P Global Indices, 1 Year return, data to 6 October 2025

Greg Fleming

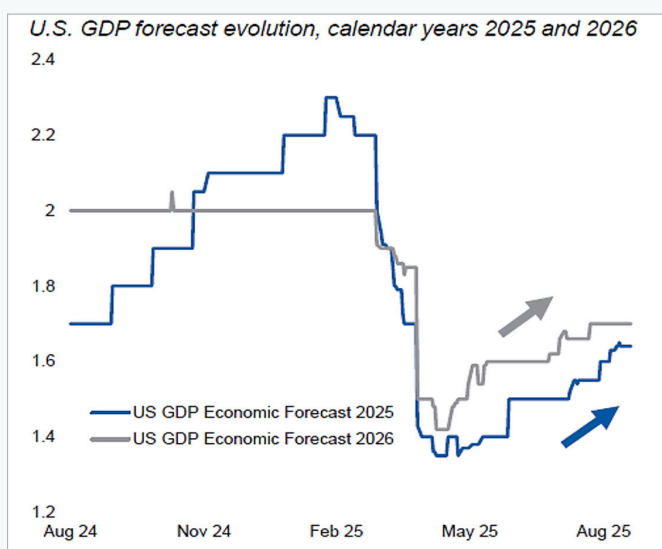
# Strategy conclusions

We expect the end of 2025 continue in a volatile fashion, as recent positive tailwinds fade for global Growth assets, but conditions should incrementally improve for select Income types. In our Income Fund, we continue to diversify via superior yield sources into the global bond markets but for the present will remain slightly below the neutral allocation in global fixed income securities. Credit spreads are tight, and sovereign yields may need to lift a touch further before we re-establish a small overweighting.

In our Capital Growth Fund, we do not yet favour buying on weakness and anticipate more volatility given the slowdown building in the US labour market and consumer confidence. We have a very modest overweighting (+1%) to Global Bonds within our Capital Growth Fund, and will retain this tilt. We are now neutral on NZ equities, neutral on Global Infrastructure and hold a reduced overweighting to Global Property.

## Our current investment market views are:

- US corporate earnings are less central to market prices, given the political and high-tech newsfeed factors, but in the medium-term earnings-derived valuations matter, to sort vulnerable from resilient enterprises. This will be tested as the US moves into “weaker but non-recessionary” growth of c.1.6% -1.8% p.a. in the Morgan Stanley economic forecasts for 2025 & 2026.



Source: Morgan Stanley Investment Management, October 2025.

- Equities (as a whole) should see average annual returns close to their long-term norms in the next 3-years, with interim weaker periods. We are not yet prepared to rule out a revisiting a period of declines if things turn more negative in international politics (i.e. involving an enduring oil price shock, Russia crisis or major tariff intensification) but a US recession would be required to derail the secular bull market.
- Selected equity sectors and markets have scope for resilience and show desirable investment features. There are all-weather stocks and defensive sectors that have lagged in recent years.
- Listed real assets still offer defensible yields, can partially hedge against economic slowdown in a fraught macroeconomic and geopolitical phase, and stand out as Cash interest rates slide.
- We see marginal compensation for duration risk in bonds. However, yield levels will remain volatile. Within fixed income, thematic support is ready to be a prime differentiator, as sovereign and corporate bonds face refinancing risks into 2026. Though so far these have been absorbed.
- We acknowledge sustainable, labelled and “green” bonds as a valuable theme, and this market will survive present US political hostility to ESG.



# SALT

Funds Management

## IMPORTANT INFORMATION

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